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SUBJECT: The Japan Economic Scope - January 19, 2007

Sensitive but unclassified. Please protect accordingly.

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¶12. (U) This cable contains the Japan Economic Scope from January 19, 2007.

¶13. (U) New Regional Economic Initiatives

At East Asia Summit (EAS) meetings in Cebu January 15, Japan engaged further on a number of new initiatives to increase its economic cooperation with other countries in the region.

Perhaps most important is the agreement among the leaders of Japan, China, and South Korea to begin negotiations on a tripartite investment treaty as well as to initiate a study on the possibility of an FTA among the three countries. Prime Minister Abe also announced a ten-item proposal calling for greater cooperation among the 16 EAS member states in such areas as energy security, disaster prevention, and people-to-people exchanges.

In addition, the EAS members agreed to launch a "Track Two" study of Japan's idea for a "Comprehensive Economic Partnership in East Asia" (i.e., ASEAN+6 FTA), an initiative that conflicts with the U.S. proposal at APEC for a Free Trade Area of the Asia-Pacific.

¶14. (U) Keidanren Board Plays Same Old Tune on Triangular Mergers

In a January 16 meeting with EMIN, the chairman of Matsushita Electric Corp., Kunio Nakamura, who also serves as chairman of Keidanren's Committee on Economic Law, insisted that Keidanren was in favor of M&A and that it supported the government's goal of increasing Japan's FDI. It was necessary, however, to have legal safeguards to protect "small investors" and prevent a loss of Japan's "sensitive" technology to foreign acquirers, he said.

According to Nakamura, Keidanren was not so concerned about investors from the United States, where there is a strong system of corporate governance and transparency in accounting rules, but many of Japan's neighbors were developing countries "where accounting rules and corporate governance were weak."

Japan needed an M&A process that ensured shareholders had adequate and accurate information on which to judge any proposed deal.

Nakamura advocated a legal review, similar to the United States' CFIUS procedure, to protect critical high technology from falling into foreign hands. Much of that technology, he asserted, was held by medium-sized enterprises that did not have the same ability as large corporations to implement defensive measures against hostile takeovers.

Despite repeated assertions that Keidanren was pro-M&A, Nakamura did not accept EMIN's point that Keidanren's strong public opposition to draft regulations on triangular mergers sent a negative signal to investors.

When EMIN suggested the GOJ and Keidanren balance that signal with statements renewing Japan's welcome of foreign investment, Nakamura blandly noted Prime Minister Abe had already done so, clearly implying he did not see the need for Keidanren to do the same.

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15. (U) Ambassador Attends American Airlines Ceremony at Narita

Ambassador Schieffer cut the ribbon at Gate 71 along with VIPs from Narita airport and American Airlines to celebrate the inaugural flight -- AA 176 to Dallas/Fort Worth -- from AA's new gate area in Terminal-2 on January 17. He also toured the new AA Admirals Club.

Narita Airport has been upgrading its facilities at Terminal-1 and Terminal-2, allowing the three major airline alliance partners to collocate their operations all under one roof in either Terminal -1 or -2.

AA's new location will bring all members of the Oneworld alliance together in Terminal-2, shortening transfer times between flights.

16. (U) Central Japan Outlook for 2007 -- Optimistic but Wary

Led by strong demand in the manufacturing sector, the economic outlook for 2007 in Central Japan is bright. That said, the regional industrial giants appear to be reaping most of the gains while their small and medium-sized suppliers continue to be squeezed. Manufacturers of all sizes face a labor shortage.

Investment in facilities and infrastructure remains high, and, publicly at least, both regional government authorities and private-sector leaders say one of their top priorities is avoiding the hubris and overreach that could turn the current good times into a bubble.

See attached Nagoya 03 for details.

17. (U) Regional Economic Integration: Kyushu Businesses to Visit Vietnam as Part of "Beyond China" Strategy

In anticipation of Vietnam becoming one of Japan's most promising economic partners along with China, members of various Kyushu public and private entities will travel to Vietnam from January 21-28 on a business mission headed by Kyushu Economic Federation Chairman Michisada Kamata.

The 30-member delegation includes representatives from METI Kyushu, Kyushu Economic Federation, Kyushu Federation of Chambers and Commerce and Industry, and companies specializing in energy, transportation, IT, finance, civil engineering, medical service, and agriculture.

Although Kyushu firms currently account for only 2.8 percent of all Japanese companies operating in Vietnam (e.g. 10 out of 361 firms), interest in Vietnam is expanding as part of local efforts to diversify regional business ties beyond the China-centric focus of the past several years.

Vietnam's accession to the WTO on January 11, 2007, and its negotiations on an economic partnership agreement with Japan provided additional impetuses for this mission and a second one in June to continue to lay the groundwork for a regular economic forum between Kyushu businesses and their Vietnamese counterparts.

¶8. (U) Reform: JFTC Reportedly to Order MLIT to Act Against Bid Rigging

In what would be a ground-breaking action, the Japan Fair Trade Commission (JFTC), according to press reports, is preparing to order the Ministry of Land, Infrastructure, and Transport to take measures to prevent bid-rigging at the initiative of government officials after it found that two former officials concerned with engineering matters in the ministry had participated in a bid-rigging conspiracy.

The case concerns a public works project to build floodgates and would be the fourth time that charges have been pressed under the 2002 Law to Prevent Public-Private Bid Rigging (kansei dango boshiho).

The JFTC action, however, would mark the first time a central government ministry has been cited under that law. The only previous application of the law to a central government entity came in the wake of the 2005 "steel bridge" scandal when the JFTC called on the Japan Highway Public Corporation to institute new anti-bid rigging measures.

¶9. (U) Government Drops White Collar Exemption; Cites Lack of "Public Understanding"

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Prime Minister Abe announced that the government would not submit amendments to the Labor Standards Law widening the white-collar exemption from overtime pay in the upcoming regular Diet Session.

MHLW had been preparing amendments to the law to exempt certain employees earning over nine million yen (\$75,000) annually from being paid overtime but the proposal drew criticism from labor unions and the opposition Democratic Party of Japan that it was merely a way for companies to implement a "zero-overtime pay system."

Abe cited a lack of "public understanding" of the new plan as the reason for the postponement.

Some CEFP members spoke publicly about the plan in December, but it was clearly not enough to overcome suspicions among union members that the outcome would be lower pay packets but not necessarily shorter working hours.

¶10. (U) Proposed Changes to Defined Contribution Pension Schemes

On a related labor issue, MHLW announced plans to revise rules for defined contribution pension schemes to allow workers to make individual payments into their accounts.

Currently, only employers can make the payments.

Under the new rules, individual employees will be able to pay up to 23,000 yen (\$200) a month, half of the current maximum paid by employers, and obtain preferential taxation treatment of the payments.

MHLW also announced plans to ease the current conditions for withdrawing funds if an employee changed jobs.

At present, an employee in such a scheme who becomes self-employed or moves to a company without such a scheme cannot withdraw his pension funds, a disincentive to labor mobility.

Under the proposed rules an employee could withdraw the funds, if the accumulated fund balance of in his account is less than 250,000 yen (\$2,170), or the participation period in the scheme is less than three years.

¶11. (SBU) Politics: DPJ Annual Convention Focuses on July Election

The Democratic Party of Japan (DPJ) held its annual convention on January 15-16. The focus of the convention was the July upper house election and DPJ President Ichiro Ozawa delivered a speech in which he vowed to stake his political life on victory.

The press noted that the atmosphere surrounding this year's convention lacked the sense of helplessness that has defined past ones, perhaps due to Prime Minister Abe's falling poll numbers and a rash of recent scandals involving Cabinet members. The Convention included five guest speakers: Social Democratic Party president Mizuho Fukushima; People's New Party secretary general Hisaoki Kamei; New Party Nippon representative Yasuo Tanaka; Japan Trade Union Confederation (RENGO) president Tsuyoshi Takagi; and Chinese Communist Party International

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Department chief Wang Jiarui.

Fukushima emphasized cooperation among the opposition parties and called on the DPJ to withhold support for the national referendum bill.

Kamei and Tanaka stressed the need to "fight jointly" (kyoutou) to defeat the LDP coalition in the July upper house election. Takagi strongly criticized the Abe Cabinet's policy favoring employers over employees and underscored the need for a worker-friendly DPJ.

Wang highlighted the importance of stronger China-Japan relations.

¶12. (U) LDP Convention Promotes "Beautiful Japan" Theme

The Liberal Democratic Party held its annual convention on January 17 during which Prime Minister Abe focused on winning the two elections in April and July and creating a "Beautiful Japan."

He pointed to passage of the Basic Education law and JDA upgrade bills in the last Diet session as evidence of his progress thus far.

Abe also promised constitutional revision, further educational reform, economic growth through innovation and openness, civil

diplomacy.

Secretary General Hidenao Nakagawa positioned the upper house

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election as a decisive battle and called for the cooperation of all LDP organizations and supporters. He also ridiculed the DPJ's new commercial (see accompanying article).

Komeito representative Akihiro Ota, the guest speaker and a much more powerful orator than Abe, repeatedly thanked the LDP for its efforts to include Komeito in every policy-making opportunity and promised to work closely with the LDP to win both elections.

LDP supporters filled an enormous hall with many attendees left standing around the edges.

The audience and upper house candidates consisted mostly of middle-aged men with a smattering of women.

¶13. (SBU) Nippon TV Correspondent on Abe, Koizumi, Upper House Elections

Nippon TV political correspondent Takayuki Kasuya outlined his views on the current Abe administration, the upcoming July upper house elections, and the possible return of former Prime Minister Koizumi on January 18 at a talk at LDP headquarters.

He began by noting that the dramatic fall in Prime Minister Abe's approval ratings can be traced partly to legacies of the previous Koizumi administration such as the prearranged town meetings and the fall of Government Tax Committee Chairman Honma, a member of the Council for Economic and Fiscal Policy during Koizumi's administration.

Kasuya opined that Koizumi had remained in power for a very long time because of the lack of scandals involving the illegal use of political funds.

He blamed Abe for neglecting to thoroughly vet some of his Cabinet members before their appointments.

Kasuya believes Chief Cabinet Secretary Shiozaki realizes there is a lack of communication among Cabinet members and is taking steps to rectify the situation.

Kasuya predicted that the LDP would lose seats in this summer's election. Asked about Koizumi returning to power if the LDP lost badly, Kasuya said he thought there was "ZERO" chance of that.

The ex-PM had already accomplished his main goal: postal privatization.

¶14. (SBU) DPJ Commercial Misses the Boat

The Democratic Party of Japan (DPJ) included a showing of its newest party commercial at its annual convention on January 16. The ad features an 18th century ship struggling against a howling storm with a bedraggled President Ichiro Ozawa struggling at the wheel.

The two other party leaders Naoto Kan and Yukio Hatoyama are also shown manning various parts of the ship.

Suddenly, a gust of wind knocks Ozawa away from the wheel and he slams against a wall behind him. Kan and Hatoyama run to his aid and Ozawa looks up at them with a slightly dazed expression as they help him to his feet. In the next scene the three men are staring off into the now blue sky.

Apparently, the commercial is meant to emphasize the teamwork of the three men.

Instead, it leaves one concerned about a ship captain unable to manage his boat in a storm.

Other questions the commercial raises include whether this

ancient ship represents the DPJ. If so, the viewer is left longing for a newer one.

Does the raging storm represent Japan's current political and economic condition? If so, many Japanese might question that view.

And finally, does the country want to be led by a man who loses hold of the ship's wheel?

In all, we assess that this commercial is a misguided effort at creating confidence in the DPJ.

¶15. (U) Agriculture: China to Resume Imports of Japanese Rice

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Agriculture Minister Matsuoka and China's top quarantine official agreed in principle on January 18 to resume rice exports to China, which had been stopped since 2003.

The two countries still need to iron out some pest issues that prompted the ban in the first place, but hope to conclude a final agreement before Prime Minister Wen Jiabao visits Japan in April, with exports to China resuming by July.

The agreement is something that Matsuoka, according to an analysis in the Japan Agricultural News, "desperately" needs to reach his goal of tripling food exports by 2013.

According to the same analysis, he also needs a success story to deflect fallout from a scandal that continues to brew over political funding allegations.

Given the extremely high price of Japanese rice, however, most observers do not anticipate a big surge in exports to China even after the agreement is completed.

¶16. (SBU) Banking: Hokkaido Banks to Merge

North Pacific Bank (Hokuyo Ginkou) and Sapporo Bank, Hokkaido's largest and third largest regional banks, announced plans to merge operations by 2008.

If realized, this will be the first bank merger in Hokkaido since the collapse of Hokkaido Takushoku Bank a decade ago.

The new bank will retain the name North Pacific Bank, but its holdings will increase to \$52.5 billion, making it the fifth largest regional bank in Japan.

Representatives from both banks promise the merger will occur without layoffs, but post's contact at North Pacific Bank tells us that anxiety among Sapporo Bank employees is high.

With the merger, North Pacific Bank and Hokkaido bank will be the only regional banks still operating in Hokkaido.

¶17. (U) Civair: Chief Cabinet Secretary Hopes for Full 24-Hour Operations at Haneda before 2009

Chief Cabinet Secretary, Yasuhisa Shiozaki noting that the Ministry of Land, Infrastructure, and Transport is studying the internationalization of Haneda Airport for when its new fourth runway opens in 2009, reportedly said he wondered if full 24-hour operations at Haneda can be realized "much earlier" at a lecture held in Tokyo on January 11 according to the press.

Prime Minister Abe has proposed 24/7 operations at airports and seaports under his Asia Gateway initiative.

Under the initiative, Shiozaki stated that the increase of international charter flights from Haneda Airport to Shanghai and

other Asian cities is under study.

He suggested that the operational hours at Narita Airport could be increased. Currently, late-night to early-morning flights are banned due to noise and arrangements with the local communities.

¶18. (U) JAL Restructuring; Further Details on Routes Emerge

Japan Airlines' restructuring moves continued to receive considerable coverage this week.

The press learned that unprofitable international routes from Kansai to Australia will be stopped in March and three times a week summer flights from Narita to Zurich will be scrapped. Flights on two routes between Narita and China will be reduced. Meanwhile, more profitable international routes that have a lot of business travelers -- Narita to New York, Hong Kong, Paris, Moscow, and New Delhi and Kansai to China -- will be augmented.

Flights to New York reportedly will increase from 10 to 13 a week, and four flights a week will be added to the current 10 flights a week to Paris. JAL is negotiating with China to increase the number of flights between Osaka and Hangzhou to three a week from two, and to increase the flights between Tokyo and Beijing.

JAL will be selling or reducing its stake in retail and hotel operations to raise cash for debt payments, according to the press articles.

JAL President Haruka Nishimatsu told the press that he would like to continue to contain costs by reducing the basic pay of JAL's workers, and perhaps cutting bonuses and retirement allowances.

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The press remains skeptical whether the steps taken so far by JAL will be enough.

Meanwhile, however, the press says JAL is seeing its stock do better in recent days due to declining oil prices. Also, reports that JAL would seek 60 billion yen in loans to cover redemption of convertible bonds have buoyed its stock.

¶19. (SBU) Boeing's Dreamlifter Takes Flight from Nagoya

The first of Boeing's "Dreamlifters," one of three modified 747-400 aircraft with triple the capacity of a standard 747 cargo plane, made its maiden flight from Nagoya to the United States on January 12, with a cargo of 787 fuselage components, marking a key milestone in the production of the Boeing 787 Dreamliner.

Christer Hellstrand, Boeing's Director of Japan 787 Production, told Nagoya Principal Officer he was "very, very, very happy" with the progress Boeing and its Japanese partners have made in meeting development and production target dates so far and said Mitsubishi Heavy Industries in Nagoya remains on track for the delivery of the first 787 wings in March. Please see attached Nagoya 04 for more details.

Note: In the interest of time, Boeing did not paint the Dreamlifter beyond its primer coat until just before it began operations. Due to its bulbous shape, wags in the aerospace sector suggested a "Weinermobile" motif and circulated a Photoshopped version of the Dreamlifter in the appropriate colors.

For reference, a copy is attached.

SCHIEFFER